

# CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 348

January 24, 1972

## SALES FACTOR

Syllabus:

1. As used in the sales factor of the apportionment formula under UDITPA (Section 25135, Revenue and Taxation Code), the word "delivered" means the place at which the purchaser takes possession and control of the property, and the word "shipped" means the transportation of the property (including delivery) to the purchaser.

2. Where property is manufactured in California but delivered by the manufacturer-seller to the purchaser in another state from which the property is immediately removed by the purchaser, neither party being otherwise taxable therein, the state in which delivery is made is the "state of the purchaser" within the meaning of Section 25135(b) and since the transaction is within the immunity granted by P.L. 86-272, the sale is attributed to California.

Advice has been requested as to the state to which receipts from the sale of tangible personal property should be attributed in the sales factor of the apportionment formula under the UDITPA where the purchaser picks up the property at the vendor's out-of-state warehouse and transports the property to California for use in this state. The vendor is subject to the taxing jurisdiction of this state.

1. Section 25135 of the California Revenue and Taxation Code (same as Section 16 of UDITPA) provides:

Sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the state of the purchaser.

The essential question to be decided is whether the phrase "delivered . . . to a purchaser . . . within this state" refers to the state in which the purchaser takes possession of the property, or the state of destination of the property in the hands of the purchaser.

Neither "delivered" or "shipped" were included in the special definitions for words found in Section 25120. Therefore, they should be given their usual, ordinary, and commonly understood meaning.

The word "delivered" in its usual and ordinary meaning denotes an actual physical passing and transfer of possession. "Shipped" is used to describe the delivery of goods to carriers for the purpose of being transferred from one place to another and implies with respect to carriage by land, a completed act, irrespective of the time or mode of transportation. Included within the meaning of this term is movement by private carrier (owned by the vendor) as well as movement by common carrier.

It is apparent that delivery may occur without shipment, or as a lesser included part of shipment. Thus, if the purchaser comes into the state of the vendor to pick up the goods, there is no shipment on the part of the vendor, only a delivery to the purchaser. However, if the vendor uses its own carriers, or common carriers, to transport the goods to the purchaser, there is a shipment (including delivery) to the purchaser. If either the delivery without shipment occurs within California, or the shipment is to a purchaser within California, then there is a California sale within the meaning of Section 25135(a).

It was necessary to use both the terms "delivered" and "shipped" in Section 25135(a), relating to property moving within or to a destination within the state, because of the possibility of the former occurring without the latter in the state of taxation.

Section 25135(b) relates only to property moving from within the state of taxation to another state. In this subsection the term "delivered" is not used, because if delivery (either with or without shipment) occurs within this state, subsection (a) will apply to assign the sale to California, and the vendor will be taxable here by virtue of the named facilities. However, in the case of shipment to a point outside the state, Section 25135(b) is necessary in order to "throw back" the sale to a state where it will be taxed.

In view of the above, it is concluded that under Section 25135 of the Law "delivered" means the place at which the purchaser takes possession and control of property, and "shipped" means the transportation of the property (including delivery) to the purchaser. Consequently, the phrase "delivered . . . to a purchaser . . . within this state" refers to the state in which the purchaser takes possession of the property (the meaning of "state of the taxpayer" is discussed infra). Applying these definitions to the question, the receipts from the sale of the property should be attributed to the state in which delivery occurred.

2. The above conclusion raises an additional question as to the state to which the receipts should be assigned if delivery of the property is made by the vendor to the purchaser in another state in which neither party is

otherwise taxable.

What must be determined is whether the state in which the transfer of possession and control occurred is the "state of the purchaser" under Section 25135(b).

There are three conceivable definitions for the phrase "state of the purchaser" as found in Section 25135(b). This phrase could mean (1) the state of the commercial domicile of the purchaser, (2) the state of ultimate destination of the property in the hands of the purchaser, or (3) the state where the property is delivered to the purchaser.

It is apparent that alternative (1) above, the commercial domicile of the purchaser, is not suitable since, under UDITPA, we are concerned with multistate corporations engaged in business in several states. In the case of these corporations, the state of commercial domicile often would have no local business activity in connection with the sale in question. Accordingly, to assign sales on this basis would not be reasonable, and this alternative must be discarded due to constitutional limitations. See Pierce, "The Uniform Division of Income for State Tax Purposes", 35 Taxes 747 (1957).

Alternative (2), the destination of goods in the hands of the purchaser also presents some severe problems. Though the tax is upon the vendor, the assignment of sales would be based upon the subjective intent of the purchaser. In many cases, the destination would not appear at all in the records of the vendor, but would only be available from the records of the purchaser, which might not be subject to the jurisdiction of the taxing state. The accounting and record keeping requirements necessitated by this alternative would place an unreasonable burden on the taxpayer, especially with respect to the information obtainable only from the purchaser.

A similar problem would arise in the case of property to be used in interstate commerce, such as an airplane, truck, or other vehicle, which might never arrive at a final "destination" in the hands of the purchaser, but has its situs allocated to a number of states for the purpose of the property factor. This alternative is unacceptable due to problems both in the determination of facts relevant to the assignment of sales, and the unreasonableness of the result reached. Further, the constitutional limitation mentioned in (1) would also apply here, if the vendor had no local business activity in connection with the sale in the state of destination.

Alternative (3), the state of delivery to purchaser, does not have the disadvantages of those previously discussed. By virtue of the delivery both the vendor and purchaser will necessarily have some local activity in connection with the sale in the state, thus the constitutional objections to alternative (1) will be avoided. Also, it will insure the assignment of the sale to a single state on the basis of information contained in the records of the vendor,

so that the problems arising from alternative (2) will not occur. Further, it is expected that in most cases, the delivery to the purchaser will be within the state in which the property will be used, so that the intent of UDITPA to apportion income to the consumer states will be reasonably effected. See *Pierce*, supra. Accordingly, the state in which the transfer of possession and control occurred is the state of the purchaser. (It is noted that the Oregon Department of Revenue has taken a contrary view (see CCH OTR 202-075) which will not be followed.)

Having determined that the "state of the purchaser" means the state in which delivery occurred, it must be determined whether the vendor would be taxable in that state solely by reason of such delivery. Section 25122 (same as Section 3 of the UDITPA) is applicable:

For purposes of allocation and apportionment of income under this act, a taxpayer is taxable in another state if (a) in that state it is subject to a state income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Accordingly, the sale will be assigned to the state from which the property is shipped unless the vendor is subject to the jurisdiction of the state in which delivery of the property was made to the purchaser. The question presupposes that the vendor is not otherwise taxable in such state.

Public Law 86-272, 15 U.S.C.A. 381, provides, in part:

(a) No state, or political subdivision thereof, shall have power to impose, . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by . . . such person during such taxable year [is]:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; . . .

The above statute has been described as a minimum standard for taxation by the states in CIBA Pharmaceutical Products, Inc. v. State Tax Commission, Missouri Supreme Court (1964), 382 S.W.2d 645. In Smith, Klein & French Laboratories v. State Tax Commission, (1965) 403 P.2d 375, the Oregon Supreme Court held that all lesser included phases of solicitation are within the exemption of P.L. 86-272.

The Oregon Tax Court, in Atlas Foundry and Machine Co. v. State Tax Commission, 2 OTR Adv.Sh. 213, held that the delivery of goods by the vendor

into the state of the purchaser was one of the lesser, included phases of solicitation within the meaning of Smith, Klein & French, supra.

In view of the above decisions, it seems clear that the vendor would be exempt from taxation in the state of delivery under the provisions of Public Law 86-272. Though there is no solicitation of orders within the state of delivery, the delivery by the vendor is certainly less than the minimum standard of activity protected under the statute, and has been defined as within the protective scope of the statute. Accordingly, the vendor would not be subject to the taxing jurisdiction of the state of delivery, and the sale would be assigned to the state from which the property was shipped under Section 25135(b).